Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of:	)	
	)	
Amendment of Part 1 of the Commission's Rules	)	WT Docket No. 97-82
	)	
Competitive Bidding	)	

REPLY COMMENTS

MCI Communications Corporation ("MCI") hereby submits its reply comments concerning installment payment issues affecting licensees in the broadband PCS C- and F- Blocks. More than sixty parties submitted initial comments reflecting a wide range of opinion on what measures (if any) the Commission should implement in response to several informal proposals for alternative financing arrangements for broadband PCS C- and F-Block licensees. The Commission's Wireless Telecommunications Bureau (Bureau) also sponsored a public forum on June 30, which provided an opportunity for representatives of C- and F- Block interests and the investment community, as well as the public, to present additional views.

MCI has carefully reviewed the initial written comments and the presentations made at the Bureau's June 30 forum. In these brief reply comments, MCI will first address three issues: (i) the importance of focusing on the end goal, attaining the objectives set forth in Section 309(j) of the Communications Act of 1934, as amended (the "Act"); (ii) the absence of any legal requirement that further proceedings be conducted before the Commission may act on the pending requests for relief; and (iii) the need for prompt, decisive and far-reaching action. MCI will then address Omnipoint's contentions that restructuring might result in a subsidy for C-Block resellers and give resellers an incentive to engage in predatory pricing.

A. Important Statutory Objectives, Including Competition And Diversity, Would Be Realized If, But Only If, Rule Changes Proposed By MCI And Others Are Adopted And Implemented.

When Congress authorized the Commission to employ a system of competitive bidding, or auctions, for awarding spectrum licenses, it enumerated a series of objectives, including "the development and rapid deployment of new...services for the benefit of the public, without administrative or judicial delays" (Section 309(j)(3)(A)); "promoting economic opportunity and competition...by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women" (Section 309(j)(3)(B)): and "recovery for the public of a portion of the value of the public spectrum resource made available for commercial use..." (Section 309(j)(3)(C)). Many of the commenters who oppose relief focus only upon the last of the aforementioned objectives, and seek to elevate recovery of the full bid price to a position of paramount importance.[1] They urge the Commission to conduct further administrative proceedings in the form of still more notice-and-comment rulemakings before considering requests for restructuring or other relief.

Not surprisingly, many of these commenters are incumbent wireless operators or licensees who benefit from further delayed entry of new competitors. Some commenters go so far as to threaten litigation unless the Commission takes action to reclaim and reauction the spectrum or otherwise vindicate their alleged rights as "losing bidders" in the C-Block auction. Some opponents suggest that the Commission allow C-Block licensees to partition or disaggregate spectrum and sell a portion to adjoining or in-market wireless licensees, a "solution" that, in many instances would not only fail to advance the statutory objective of promoting economic

[1] It is notable that many of the parties who oppose any relief have themselves received the right to use, or to continue to use, valuable spectrum without any substantial payment whatsoever, via waivers (Nextel – formerly Fleet Call; see 6 FCC Rcd 1533 (1991)), wireline set-asides (BellSouth, Southwestern Bell, Sprint Corp.), or lotteries (Point Enterprises), or have obtained the right to claim a license without competitive bidding via pioneer's preference grant (OmniPoint). Having "gotten theirs," the incumbents oppose the admission of anyone else to their exclusive club.

opportunity and competition, but one which would run directly contrary to the statutory mandate to avoid excessive concentration of licenses. [2]

There have been a number of proposals presented to the Commission which are worthy of consideration. Ultimately, the Commission's decision should be based on an evaluation of which course best achieves the objectives of Section 309(j) and, more broadly, the public interest. Neither the objectives of Section 309(j) nor the public interest will be served if the Commission fails to act quickly and decisively, if it fails to reduce the net present value of C-Block bids to $10 per POP or less, or if it imposes unreasonable and commercially unacceptable conditions on any restructuring plan it may ultimately adopt. Neither competition nor consumers will be well served by the adoption of halfway measures that, in the end, fail to assure viability of the C-Block as a whole.

Further, the Commission must ensure that its control group, ownership and attribution, and unjust enrichment restrictions are not so stringent as to effectively foreclose otherwise available sources of funding, either domestic or foreign. The Commission should streamline and simplify the control group rules, ownership and attribution rules, so that the control group is only required to maintain de jure and de facto control.[3] Changes are needed in three areas: allowing the control group and potential investors to determine the percentage of equity held by the control group through negotiation;[4] allowing up to 49.9 percent of the equity to be held by a single minority

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[2] Compare ALLTEL at 4-5, advocating that the Commission "require distressed licensees [to explore assignment, partitioning and disaggregation] opportunities prior to providing some other form of administrative largesse" with Horizon Personal Communications at 8: "If the current financial climate destroys most of the C-Block players, only those C-Block licensees who are aligned with A-, B-, D- or E-Block carriers will be able to move forward unaffected."

[3] See, e.g., Duluth PCS at 2, Fortunet at 5, Indus at 3, and OnQue at 6.

[4] OnQue at 6.

shareholder;[5] and allowing foreign investment up to the limits authorized in the forthcoming Commission rules implementing the WTO agreement on Basic Telecommunications.[6] These changes would maximize the potential pool of investors, while at the same time ensuring both that entrepreneurs retain control of the entrepreneur block licenses and that viable businesses emerge from this process.

Although some opponents assert that "a deal is a deal" and the C-Block bidders should be required to "make the government whole," the comments and presentations by Toronto Dominion, Bear Stearns, The Yankee Group and others have clearly and persuasively demonstrated that the capital markets will not now fund these systems. Further evidence that the capital markets will not support high per pop valuations for C-Block systems (which will typically be the fourth or fifth broadband wireless entrant in major markets) is provided in the attached exhibit. The attached diagram depicts market value, on a per-POP basis, of representative domestic and international wireless operators. This diagram clearly shows that the incumbent monopoly and duopoly carriers possess a substantial advantage (in terms of their ability to create shareholder value) vis a vis later entrants. The "Spectrum Economics" exhibit attached to MCI's initial comments illustrated the substantial disadvantage that new entrants face when they are required to compete with incumbents who paid lower spectrum fees or no fees at all. By year 10, we projected that C-Block licensees will be required to allocate 38% of their total revenue to repayment of spectrum costs, as against only 13% for the largest A/B Block licensees and zero for cellular. Imposition of spectrum fees on only the latest entrants exacerbates the time to market and other disadvantages (e.g., smaller coverage areas) that they

[5] MCI had earlier proposed that the Commission permit the amount of equity held by a single non-attributable investor to be increased from 25% (1/3 of the total non-control group equity) to 37.5% (1/2 of the total non-control group equity). In light of the comments of General Wireless, Inc. (proposing an increase to 49%) and Fortunet (advocating the application of the WCS attribution rules), MCI now believes there is no inherent reason for limiting the flexibility of any DE to take advantage of financing opportunities, including those that may entail a 49.9% single minority shareholder, so long as de facto and de jure control rests with the control group.

[6] See, e.g., Fortunet at 6-7, Indus at 5-6. Pending the adoption of rules implementing the WTO agreement (which may completely remove barriers to investment from certain nations and liberalize the restrictions as they relate to investment from other nations), the Commission may still require that specific investors and the proposed ownership structure be submitted for prior approval.

already face. This new data further supports the view expressed by many commenters that, if the Commission were to reclaim and reauction the spectrum, it would be unlikely to receive bids anywhere near those received in the first auction. In fact, more recent wireless auction results and current valuations on the attached exhibit suggest that rational valuations are below $10 per POP, as articulated by many of the financial witnesses.

Perhaps the financial situation would have been different had the Commission been able to conduct the C-Block auction concurrently with the A and B-Block auction, or immediately after the A- and B-Block auction as it had originally intended, or if there had not been a general (and significant) downturn in the market valuation of wireless stocks following the C-Block auction, or if the Commission had adopted a different set of rules (*e.g.*, if it had not claimed a first lien position vis a vis equipment vendors and those providing buildout capital, or if it had imposed less stringent limits on the percentage of equity held by the members of the control group). However, it is not possible to turn back the clock and the Commission must now decide how best to achieve its objectives going forward. MCI continues to believe that the best course is for the Commission to make available a restructuring plan or series of restructuring options which incorporate significant changes in financing terms. It is critical that this restructuring plan be aggressive enough to assure the financing and rapid deployment of C-Block licensees' systems.[7] As described above, MCI supports streamlining and simplification of the control group, ownership and attribution rules. The Commission should also consider relaxation of the unjust enrichment rules, particularly in situations where an entrepreneur block licensee is unable to finance buildout of one or more geographic areas, and no purchase offers are received from a designated entity within a reasonable period of time.

[7] As explained by Holland et al. at 1 and Horizon at 2-3, it is necessary for C-Block to be broadly successful if PCS subscribers are to enjoy wide availability of service and roaming capabilities.

B. There Is No Legal Requirement That Further Proceedings Be Conducted Before The Commission May Act On The Pending Requests For Relief.

Several commenters assert that the Commission may not proceed on a waiver basis, but must conduct a further notice and comment rulemaking before authorizing restructuring of C-Block debt or revising the C-Block and F-Block payment terms, either for individual licensees who are facing potential default or for licensees generally. The Commission has broad discretion in determining, in a given instance, whether it should proceed through the adoption of general rules, or on a more particularized basis. Those who argue that the purpose of the rule would be eviscerated if the Commission were to grant numerous waivers ignore the fact that the Commission often proceeds on just such a basis. For example, last Fall the Wireless Bureau issued an order (DA 96-1726, Released October 23, 1996) adopting criteria by which the Licensing Division was to process approximately three thousand three hundred (3,300) requests for waiver of the 800 MHz SMR licensing freeze.[8] Whether the Commission decides to modify the rules generally, or to grant relief in particular instances,[9] there is no need to conduct a further notice and comment proceeding. The Commission has a proceeding underway (the instant docket) in which it is considering revisions to its rules for auctions, including a number of the same changes advocated in comments submitted in response to the Bureau's notice. The notice solicited comment on issues related to C-Block and F-Block installment payments; there can be

[8] BellSouth, at 22, asserts that "MCI is asking the Commission to eviscerate the rule" by urging the Commission to grant requests for relief on an as-needed basis, and that if the MCI-recommended approach were adopted, "the decision whether to grant a waiver would essentially be automatic, not a decision based on rational, articulated standards as required by the case law." Similarly, CIRI asserts that any waiver policy would be inherently arbitrary and vulnerable to a court challenge. Neither allegation is true. Under the approach MCI recommends, either the Commission, or the Bureau acting under delegated authority, would adopt rational, articulated standards which could then be applied in similar cases as the need arose. That is precisely what the Commission has done in numerous instances, including the 800 MHz SMR license freeze decision cited in the text, and neither BellSouth, CIRI nor any other party has demonstrated that it cannot lawfully be done here.

[9] Some parties, including BellSouth (at 21), assert that the Commission is somehow limited to the narrow "grace period" relief described in Section 1.2110(e)(4)(ii). The "grace period" provision was adopted early on, at a time when the Commission did not foresee the possibility that there would be numerous requests for relief or that requests for relief would occur prior to a technical default (i.e., failure to make payment when due). The provision does not in any way limit the Commission's flexibility to respond to changed circumstances. The Commission has authority, in appropriate cases, to suspend its rules (as it has done in the case of the March 31 installment payments) or to grant relief through rule modifications or waivers.

no doubt, judging by the numerous comments filed and the number of participants and attendees at the June 30 public forum, that interested parties have received adequate notice and have been given an opportunity to make their views known. There is simply nothing to be gained (apart from further delay, which may be the objective of some commenters who operate systems against which entrepreneurs will eventually compete) by releasing a separate notice of proposed rulemaking covering the same issues.

C. In Order To Maximize Benefits To Consumers And Competition, The Commission Must Act Quickly and Decisively; Half Measures Are Not Sufficient.

Whatever steps the Commission takes, it needs to move quickly and decisively. Failure to act will disserve the interests of consumers and competition. Failure to act aggressively will result in the inability of licensees to obtain needed funding to build their systems, further delaying much-needed competition that entrepreneurs and small business owners are hoping to bring to the wireless market.

To underscore this point, MCI submits the following excerpt from the "Bensche Marks" a newsletter of Lehman Brothers analyst John M. Bensche, released July 1, 1997, summarizing the second panel at the June 30 forum.

> The finance panel was much more unified in their points of view. The panelists were Norm Frost of Bear Stearns, Brian O'Reilly of Toronto Dominion Bank, Gregg Johnson of BIA Capital, Mark Lowenstein from The Yankee Group, and [John Bensche] from Lehman Brothers. The charge to this panel was to comment on the restructuring proposals rather than debate whether a reauction or restructuring was preferable. The panel was uniform in stating the current discounted debt per-POP of approximately $23 was above the asset value the capital markets were willing to attribute to PCS enterprises. Any "fix" should be significant enough to bring the NPV of the debt well below the current asset values (ballpark of $20 for public PCS companies), hence creating some equity value. No one came down firmly on a specific restructuring proposal, but general consensus seemed to be that a restructuring should get to a maximum of $10 per-POP, and preferably lower.

> Even at this level, there is still risk that the capital markets could balk. We made the point that investors would discount the C relative to the A and B comps due to time to market, and we also theorized that FCC relief for the C could negatively impact the values of the A and B stocks off which the C would be priced. We provided a few charts showing how a restructuring incorporating an equity stake being transferred to the government could allow the FCC to eventually recoup the debt it is being asked to forgive, and perhaps plot a middle ground between the vehement opposition to a restructuring and the public interest.
>
> Even if the debt is restructured downward, most panelists indicated that the government would probably have to give up its first lien position on the spectrum, or at least share it, if any bank, vendor or high-yield debt capital was to be attracted. Particularly in regards to proposals that a pre-payment or an open market sale of the restructured debt be allowed, the transferability of the lien would be required to generate any interest in that paper. Johnson made the point that for companies below the mega-C players, the public markets and debt markets were constrained, and the smaller entities would have to sell equity to pre-pay government debt, hence making a pre-payment scheme unworkable except for a few of the biggest players. All panelists encouraged the FCC to act quickly and decisively.

In summary, the public interest will not be served if the Commission fails to act quickly and decisively, if it imposes unreasonable and commercially unacceptable conditions on any restructuring plan, or if it fails to reduce the spectrum cost of the C-Block licensees to a level at or below the A- and B-Block spectrum cost. Halfway measures that fail to assure the desired outcome will both frustrate entrepreneurs and postpone competition. The Commission should streamline and simplify the control group rules, ownership and attribution rules, so that the control group is only required to maintain de jure and de facto control. These changes would maximize the potential pool of investors, while at the same time ensuring both that entrepreneurs retain control of the entrepreneur block licenses and that viable businesses emerge from this process. There is an urgent need for prompt, decisive and far-reaching action, if competition and economic opportunity is to become a reality.

D. Omnipoint's contentions that debt restructuring would subsidize resellers and promote predatory pricing are without merit.

1. *Omnipoint expresses concern that restructuring license debt might result in a "significant and artificial subsidy" for large retailers of C-Block services.*

The terms and conditions of the resale agreements between C-Block licensees and resellers were negotiated before restructuring and there is no evidence that these agreements will be altered after restructuring. Therefore, the proposed debt restructuring will not result in a subsidy for resellers of C-Block services. Indeed, for a subsidy to exist for resellers after the debt restructuring, such a subsidy must also have been present in the transfer price negotiated before debt restructuring.[10] Omnipoint makes no logical case for why a negotiated transfer price that was agreed upon before debt restructuring, which certainly would be presumed to be above marginal cost, is suddenly below marginal cost simply due to a restructuring of debt.[11]

2. *Omnipoint further contends that debt restructuring will give "the reseller every incentive to engage in predatory pricing to eliminate competition.... (p. 7)"*

Predatory pricing occurs when a firm with significant monopoly power reduces its price below the short-run profit maximizing level in order to drive its rivals from the market so that, following their exit, price can be raised above the level that could otherwise be sustained.[12] Predatory pricing, then, is specifically designed to monopolize a market. Given the market structure in mobile communications, a predatory strategy by the C-Block licensees is highly unlikely. First, the C-Block retailers are (in effect) the sixth entrant into the mobile communications market and possess no significant monopoly power. Second, the C-Block licensees control less than one-fifth of the spectrum capacity presently employed for mobile

[10] This point assumes that debt restructuring were not anticipated by the parties and thus had no impact on the previously reached agreements.

[11] A subsidy is a direct payment made by the government which drives a wedge between the production cost of a good or service and the price paid for that good or service by customers, with the retail price being less than the marginal cost of production.

[12] See David L. Kaserman and John W. Mayo, Government and Business: The Economics of Antitrust and Regulation, Orlando, FL: The Dryden Press (1995)

communications services.[13] It would be impossible, under this technical constraint, to monopolize the mobile services market. Third, even if a predatory strategy was successful at eliminating rivals (which, given the first two points, is impossible), the spectrum and equipment of the eliminated firms could likely be brought back on-line without substantial sunk costs as soon as the C-Block retailers attempted to raise the price to the monopoly level.[14] Fourth, without substantial sunk costs since the C-Block licensees and resellers negotiated the transfer prices before debt restructuring, the incentives of resellers remains unchanged. Finally, it is unclear why a reseller of services would choose to incur losses (via a predatory strategy) in order to benefit another party (the C-Block licensees). Clearly Omnipoint's concern regarding predatory pricing is overstated.

WHEREFORE, MCI respectfully requests that the Commission take its views, as expressed in its initial comments and these reply comments, into account in acting on the important issues raised in this proceeding.

Respectfully submitted,
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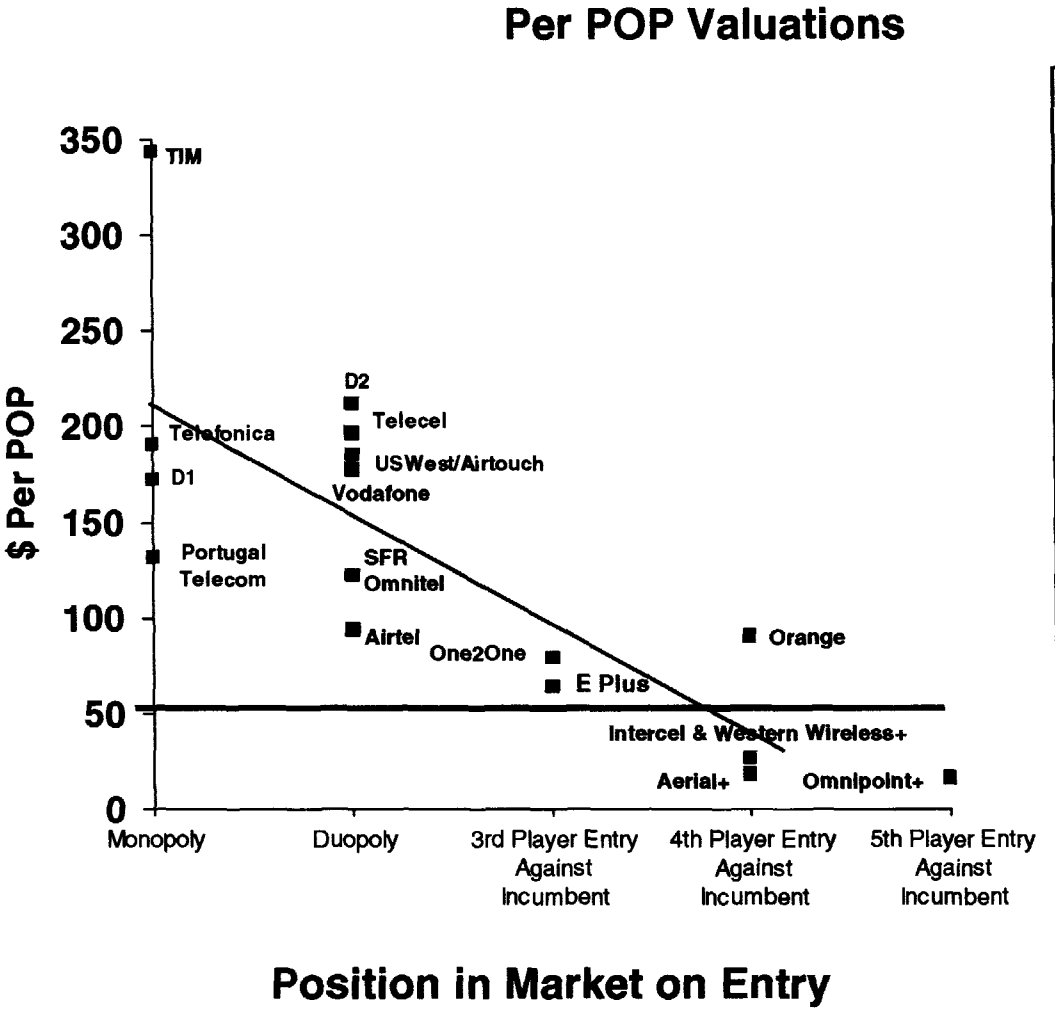
[13] Counting two cellular providers and the A, B, C, D, and F Blocks, there is a total of 170 Mhz allocated for personal mobile communications services. The C block controls only 30 Mhz (or 17.6 percent). C-Block licensees cannot substantially increase their share of spectrum capacity due to the FCC's present spectrum cap.

[14] Note that since the C-Block licensees have contracted with multiple retailers, a predatory strategy would require all the C-Block retailers to engage in a concerted effort to "eliminate competition" of all types other than, of course, C-Block retailers.

Market valuations of operators have changed over time



(+) MCI calculation based on shares outstanding times market price per share as of March 97, plus long term debt, minus cash, divided by POPs. Sources: Company 10Qs, March 97 and DLJ.

USWest/Airtouch figures based on Merrill Lynch analysis, March 97.

Source of all other figures is BZW Research Limited.

— Spectrum and Network Cost/POP Source: DLJ - Typical PCS Company

CERTIFICATE OF SERVICE

I, John E. Ferguson III, do hereby certify that copies of the Reply Comments of MCI in the Matter of the Amendment of Part 1 of the Commission's Rules on Competitive Bidding were sent, on this 8th day of July, 1997, via first-class Mail, postage pre-paid, to the following:

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